

1.1 Opinion

The audit of the financial statements of the MBSL Insurance Company Limited (“Company”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the statement of profit or loss and other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Emphasis of Matter

Without qualifying my opinion, I draw attention to Note 13 to the financial statements on Analysis of Tax (Differed Tax Assets recognition) in the preparation of the financial statements. As stated in the above note, MBSL Insurance Company Limited is liable to income tax at 28% in terms of Inland Revenue Act No. 24 of 2017 and amendments thereto. Current year income tax charge wholly consists of income tax charge on General Insurance division. However, there is no payment due to the Department of Inland Revenue as the tax liability is fully absorbed by payments made in lieu of Economic Service Charge and credit available on the Notional Tax from government securities.

As per the Inland Revenue Act No 24 of 2017 which is effected from 1st April 2018, 100% of Taxable Income is allowed to be deducted against the Tax Losses incurred whereas under the previous Act, deduction was limited only to 35% of total statutory Income. According to the transition provisions of the new Act, the brought forward, Tax Losses can be claimed against Taxable Income for a period of six years, commencing from year of assessment 2018/19.

The Board of Directors carefully analyzed the availability of future taxable profits against which the unused Tax Losses can be utilized after lifting the suspension of the License imposed by the Insurance Regulatory Commission of Sri Lanka (IRCSL) and infusion of the new Share Capital as explained in the Note 33 and 37. For this purpose an Assessment of future taxable profits has been done as explained in the Note 13.1.

The tax losses carried forward as at 31st December 2018 is Rs.1,812 million (2017 is Rs.1,674 million) as detailed in the Note 13.2. The Company has recognized Rs. 506.2 million as the Differed Tax Assets consequent to the changes in the Inland Revenue Act No. 24 of 2017 as explained in the Note 13.4. The reconciliation between tax expense and the product of accounting profit multiplied by the statutory tax rate is given in the Note 13.3.

1.2 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Company.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
- Whether the Company has performed according to its powers, functions and duties; and
- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Financial Statements

1.5.1 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
A value of Rs.90, 829,000 of assets had been used by the company even though their estimated useful life was over. In terms of LKAS 8- Accounting Policies, Changes in Accounting Estimates and Errors, steps had not been taken to revalue the said assets and include that in the financial statements after considering the useful lifetime.	The Company's fixed assets have been depreciated according to the depreciation policy that has been widely adapted in the industry. The above mentioned fixed assets carry zero net book value and it is beneficial for the Company to use assets with due care.	Should comply with the standard.

1.5.2 Documentary Evidences not made available for Audit

Audit Issue	Management Comment	Recommendation
Loan agreements for twelve loans amounting to Rs.208, 822,674 obtained from Merchant Bank of Sri Lanka & Finance PLC which is the parent company, were not available to the audit.	These loan agreements are not available with us and we have requested them from Merchant Bank of Sri Lanka & Finance PLC during the audit. They have sent scanned copies of five (05) agreements through email and we have forward them to Auditors. Also, these short term loans were rescheduled on May 2019 and the rescheduled agreement has been attached for your reference.	Relevant documents should be provided to the Audit.

1.6 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Non-compliance Rules Regulations etc.	Management Comment	Recommendation	
Regulation of Insurance Industry (Amended) Act no 3 of 2011.	Long term Insurance business and General Insurance business had not been	IRCSL has given a deadline i.e. 01 st April 2020 for the Company to segregate the two	Should comply with the Act.

segregated by the businesses accordingly company as at 31 December 2018. a segregation plan has been submitted to IRCSL for their approval.

1.7 Cash Management

Audit Issue	Management Comment	Recommendation
A Board of Survey had not been appointed by the management regarding the physical verification of cash at office as at the end of the year under review.	The Company maintains a petty cash float for its day to today petty expenses. The Company will appoint a board of survey to physically verify the cash at office from this year onwards.	Steps should be taken to appoint a Board of Survey.

1.8 IT General Controls

Audit Issue	Management Comment	Recommendation
Followings weaknesses in the Information Technology (IT) department have been observed.		
a) Regular information security awareness programs had not been conducted by the company regarding the communication of IT security best practices and procedures for the maintenance of security compliance throughout the company.	The observation is duly noted and a process will be implemented by the end of year to addresses the issue.	Regular information security awareness programs should be conducted.

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| b) Non availability of Business Continuity Plan (BCP) and Disaster Recovery Plan (DRP). | The observation is duly noted. Company will take necessary steps to have a BCP and a DR site considering the availability of the funds as this will carry a high cost. | Steps should be taken to establish a Business Continuity Plan and a Disaster Recovery Plan. |
| c) Non availability of information security policy. | The observation is duly noted and a process will be implemented by the end of year to have an information security policy. | Steps should be taken to implement an information security policy. |
| d) Non availability of records of IT assets. | Company does have an IT asset registry and any acquisition or Disposal has been updated. But a physical verification has not been carried out from the inception of the Company. We will take necessary steps to complete IT assets register with a physical count. | Steps should be taken to complete IT assets register with a physical count. |

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit Rs. 358 Million and the corresponding loss in the preceding year amounted to Rs. 45 Million. Therefore an improvement amounting to Rs. 403 million of the financial result was observed. The reasons for the improvement were poorly differed tax assets recognized the year. Even though the business was suspended during the year management computed the differed tax assets based tax loss and recognized in the account.

2.2 Trend Analysis of major Income and Expenditure items

Turnover and the Profit/Loss for last four years were as follows.

Year	2018	2017	2016	2015
Gross Written Premium (Rs. Mn)	65.33	384.54	1,244.76	1,301.11
Net profit/ loss after tax (Rs. Mn)	358.169	(45.32)	(231.18)	(108.87)

Reason for drop in the Gross Written Premium during the year 2017 and 2018 was suspension of the business of the company by the Insurance Regulatory Commission of Sri Lanka (IRCSL) on 28 June 2017.

2.3 Ratio Analysis

According to the financial statements and information made available to audit, some important ratios for the year under review as compared with the preceding year are given below.

Ratios	2018	2017
Current assets ratio	2.69	3.94
Quick assets ratio	2.66	3.84
Gross profit ratio	72%	86%
Return on capital employed	-0.19	-0.05
Gearing Ratio	760%	3679%

Comparatively all these ratios were favor in the year 2017 because up to June 2017 business was operated and from June 2017 business was suspended until April 2019.

3. Operational Review

3.1 Idle or underutilized Property, Plant and Equipment

Audit Issue	Management Comment	Recommendation
A Board of Survey had not been appointed by the management regarding the physical verification of the assets as at the end of year under review for the identification of excess assets, unusable/expired assets, damaged assets and any deficiency.	The management will appoint a board of Survey to verify the fixed assets.	A Board of Survey should be appointed to verify the Fixed Assets.

Further, master fixed assets register maintained in the Head office had not been updated on timely basis.	During the year additions and disposals have been updated in the master fixed assets register before finalizing the annual accounts of the Company. We have planned to carry out fixed asset verification and update the register in order to maintain up to date master file.	Master Fixed Assets Register should be updated on timely basis.
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4. Accountability and Good Governance

4.1 Internal Audit

Audit Issue	Management Comment	Recommendation
Separate internal audit division was not available in the company to overlook the internal control and operational effectiveness, efficiency and risk related to business and inform the relevant high authority.	There are plans to either establish an in-house internal audit Department or to outsource the function. The Management is in the process of going through current policies and procedures of the Company in order to update the same to meet the internal controls and current regulatory requirements. The sooner the process is completed, outsourcing the internal audit function or setting up a division will be completed.	Steps should be taken to establish an in-house internal audit department or to outsource the function.

4.2 Audit Committee

Audit Issue	Management Comment	Recommendation
Separate Audit Committee responsible for the review of accounting, internal control system and make any recommendations to the management was not available.	The Company is in the process of establishing the required Board sub-committees to comply with the applicable Governance requirements.	Steps should be taken to establish an Audit Committee.

